MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Good afternoon, the Vice-President and I welcome you to our press conference.

The Governing Council today decided to raise the three key ECB interest rates by 75 basis points. With this third major policy rate increase in a row, we have made substantial progress in withdrawing monetary policy accommodation. We took today's decision, and expect to raise interest rates further, to ensure the timely return of inflation to our two per cent medium-term inflation target. We will base the future policy rate path on the evolving outlook for inflation and the economy, following our meeting-by-meeting approach.

Inflation remains far too high and will stay above our target for an extended period. In September, euro area inflation reached 9.9 per cent. In recent months, soaring energy and food prices, supply bottlenecks and the post-pandemic recovery in demand have led to a broadening of price pressures and an increase in inflation. Our monetary policy is aimed at reducing support for demand and guarding against the risk of a persistent upward shift in inflation expectations.

The Governing Council also decided to change the terms and conditions of the third series of targeted longer-term refinancing operations (TLTRO III). During the acute phase of the pandemic, this instrument played a key role in countering downside risks to price stability. Today, in view of the unexpected and extraordinary rise in inflation, it needs to be recalibrated to ensure that it is consistent with the broader monetary policy normalisation process and to reinforce the transmission of our policy rate increases to bank lending conditions. We therefore decided to adjust the interest rates applicable to TLTRO III from 23 November 2022 and to offer banks additional voluntary early repayment dates.

Finally, in order to align the remuneration of minimum reserves held by credit institutions with the Eurosystem more closely with money market conditions, we decided to set the remuneration of minimum reserves at the ECB's deposit facility rate.

The decisions taken today are set out in a press release available on our website. The details of the changes to the TLTRO III terms and conditions are described in a separate press release to be published at 15:45 CET. Another technical press release, detailing the change to the remuneration of minimum reserves, will also be published at 15:45 CET.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

Economic activity in the euro area is likely to have slowed significantly in the third quarter of the year, and we expect a further weakening in the remainder of this year and the beginning of next year. By reducing people's real incomes and pushing up costs for firms, high inflation continues to dampen spending and production. Severe disruptions in the supply of gas have worsened the situation further, and both consumer and business confidence have fallen rapidly, which is also weighing on the economy. Demand for services is slowing, after a strong performance in previous quarters when those sectors most affected by the pandemic-related restrictions reopened, and survey-based indicators for new orders in the manufacturing sector are falling. Moreover, global economic activity is growing more slowly, in a context of persistent geopolitical uncertainty, especially owing to Russia's unjustified war against Ukraine, and tighter financing conditions. Worsening terms of trade, as the prices paid for imports rise faster than those received for exports, are weighing on incomes in the euro area.

The labour market continued to perform well in the third quarter, and the unemployment rate remained at the historically low level of 6.6 per cent in August. While short-term indicators suggest that jobs were still being created in the third quarter, the weakening of the economy could lead to somewhat higher unemployment in the future.

To limit the risk of fuelling inflation, fiscal support measures to shield the economy from the impact of high energy prices should be temporary and targeted at the most vulnerable. Policymakers should provide incentives to lower energy consumption and bolster energy supply. At the same time, governments should pursue fiscal policies that show they are committed to gradually bringing down high public debt ratios. Structural policies should be designed to increase the euro area's growth potential and supply capacity and to boost its resilience, thereby contributing to a reduction in medium-term price pressures. The swift implementation of the investment and structural reform plans under the Next Generation EU programme will make an important contribution to these objectives.

Inflation

Inflation rose to 9.9 per cent in September, reflecting further increases in all components. Energy price inflation, at 40.7 per cent, remained the main driver of overall inflation, with an increasing contribution from gas and electricity prices. Food price inflation also rose further, to 11.8 per cent, as high input costs made food production more expensive.

Supply bottlenecks are gradually easing, though their lagged impact is still contributing to inflation. The impact of pent-up demand, while weakening, is still driving up prices in the services sector. The depreciation of the euro has added to the build-up of inflationary pressures.

Price pressures are evident in more and more sectors, in part owing to the impact of high energy costs feeding through to the whole economy. Measures of underlying inflation have thus remained at elevated levels. Among those measures, inflation excluding energy and food rose further to 4.8 per cent in September.

Strong labour markets are likely to support higher wages, as is some catch-up in wages to compensate for higher inflation. Incoming wage data and recent wage agreements indicate that the growth of wages may be picking up. Most measures of longer-term inflation expectations currently stand at around two per cent, although further above-target revisions to some indicators warrant continued monitoring.

Risk assessment

The incoming data confirm that risks to the economic growth outlook are clearly on the downside, especially in the near term. A long-lasting war in Ukraine remains a significant risk. Confidence could deteriorate further and supply-side constraints could worsen again. Energy and food costs could also remain persistently higher than expected. A weakening world economy could be an additional drag on growth in the euro area.

The risks to the inflation outlook are primarily on the upside. The major risk in the short term is a further rise in retail energy prices. Over the medium term, inflation may turn out to be higher than expected if there are increases in the prices of energy and food commodities and a stronger pass-through to consumer prices, a persistent worsening of the production capacity of the euro area economy, a persistent rise in inflation expectations above our target, or higher than anticipated wage rises. By contrast, a decline in energy costs and a further weakening of demand would lower price pressures.

Financial and monetary conditions

Bank funding costs are increasing in response to the rise in market interest rates. Borrowing has also become more expensive for firms and households. Bank lending to firms remains robust, as they need to finance high production costs and build up inventories. At the same time, demand for loans to finance investment has continued to decline. Lending to households is moderating, as credit standards have tightened and demand for loans has decreased in a context of rising interest rates and low consumer confidence.

Our most recent bank lending survey reports that credit standards tightened for all loan categories in the third quarter of the year, as banks are becoming more concerned about the deteriorating outlook for the economy and the risks faced by their customers in the current environment. Banks expect to continue tightening their credit standards in the fourth quarter.

Conclusion

Summing up, today we have raised the three key ECB interest rates by 75 basis points, and expect to raise interest rates further, to ensure the timely return of inflation to our medium-term target. With this third major policy rate increase in a row, we have made substantial progress in withdrawing monetary policy accommodation. The changes to the terms and conditions of our targeted longer-term refinancing operations will also contribute to the ongoing policy normalisation process.

Our future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach. We stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term inflation target.

We are now ready to take your questions.

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Could you tell us whether you are comfortable with the expectation that interest rate steps are going to slow after today's decision and peak somewhere around 3% next year?

Secondly: since we're now at the lower end of the neutral rate estimates, would it be fair to assume that the ECB could be ready to lay out a plan for reducing its balance sheet at its next meeting in December?

So that is a bag of questions that you put into one question! What we have done with the decision taken today is making yet more progress in withdrawing the accommodative [policy] and [the] support to demand that was made available. So we have made substantial progress in withdrawing that. Have we completed the job? Have we finished the normalisation of our monetary policy as we have called it? No. There is still ground to cover. What we have reiterated now is that we are going to decide the future path and pace of our rate increases on the basis of the data that we have, and we will do so meeting-by-meeting. So we are very much and deliberately turning our back to forward guidance, which is not helpful in the current circumstances given the level of uncertainty that we have pretty much all around.

So what we are saying here is: Number one, we continue and make substantial progress in withdrawing. We will have further rate increases in the future so the normalisation process continues. At some point in time, we will have of course to identify the rate which will deliver the 2% medium-term target that we have. So the destination for us is clear. The exact pace will be determined meeting-by-meeting. To do that, as I said, it will be data dependent and it will be meeting-by-meeting but we will look precisely at three key factors. Just to give you a bit of flavour of how we are going to work in the next meetings that we have.

First, we will look of course at the inflation outlook, which takes into account the evolution of the economy, including the higher likelihood of a recession. So number one is the inflation outlook, this is what we are fighting, it’s inflation, that's the first one. Second is, we will also take into account the measures that we have taken so far because in the last three meetings including this one, we have hiked by 200 basis points. Third, we will also be attentive to the transmission lag of monetary policy and we know, as we do that, that any decision that we make is not going to have an immediate impact on inflation, but will be subject to the time lag that always affects monetary policy decisions. That gives you – I hope – a bit of the flavour of the thinking and the rationale behind those decisions that will be made and those hikes that we will decide in the near future.

I think you had a second question which had to do with our balance sheet, so you covered it all in one question – not all because there are lots of other interesting and decisive matters that we discussed. Well, let us call it the reduction of our APP monetary portfolio. This is a matter that we have discussed at our last retreat amongst ourselves, the governors. We did not discuss the substantive issues today – deliberately – because we decided on a lot of issues. But what we decided is that we would pursue that discussion and we would decide the key principles of the reduction of our APP monetary portfolio in December. So that gives you a bit of an indication of when those key principles will be discussed and decided, and I will be very pleased to inform you about those principles at our next monetary policy meeting in December. And that has to be of course in advance of the decision to implement and to roll out this reduction.

Two questions for you. The first is with respect to the neutral rates. You said at the last meeting – and this is a quote – “What I can tell you is that the further away we are, the larger the step we are taking, which is why we are front-loading now.” Given that the deposit rate is now 1.5